Franchise Combat
The Franchisor & Franchisee Relationship Dynamic
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Abstract

The unique characteristics of franchises can lead to a taxed relationship dynamic between the franchisor and franchisee. This report aims to understand sources of conflict between the two parties and potential solutions to improve the quality of this working relationship. The analysis begins with background information on franchising in general. This information helps build the foundation of the discussion on some of the key problems both franchisees and franchisors face in their roles. The analysis culminates in a discussion of potential solutions to address these problems. This report is not intended to be an exhaustive study of the franchise industry, but rather a creative look at problem identification and conflict management.
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Introduction

Franchisors and franchisees are ultimately working towards the same goal: maximizing the profit and growth of their business. Despite this shared goal, it can often be difficult to avoid some level of conflict between the two parties. This report will analyze this conflict and solutions to resolving conflict for franchisors and franchisees. This conflict analysis is built upon an overview of the industry and the components of the relationship for the franchisor and franchisee. This overview brings the source of the relational conflict to light and helps to justify the solutions. This report aims to go beyond metric measures of performance and assess the subjective and human side of a business relationship in the world of franchises.

Franchising: An Overview

Franchising is they ultimate blend of two professional paths: working for someone else and working for yourself. This way of participating in business shouldn’t be confused as a separate industry. Simply, this is a method of business that can be practiced in many different fields. There are characteristics of franchising that reflect both corporate practices and sole proprietorships. The Internal Franchise Association, which serves as a liaison and support system for the practices states, “Franchising is a method of distributing products or services. At least two people are

2 Teixeira, Ed. Franchising from the inside out. [United States]: Xlibris Corporation, 2005. Print.
involved in the franchise system: 1) the franchisor, who lends his [or her] trademark or trade name and a business system; and 2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor’s name and system.” This system of exchange illustrates the give and take of the relationship between franchisor and franchisee. In this relationship both parties add value to each other and the overall goals of the business. Both parties have an invested financial incentive to see the company be successful.

The success of any franchise is highly dependent upon the collective success of franchisees. It is important for the majority of franchisees to run profitable store units and help to enhance the brand equity. It is also crucial that the franchisor manages the brand effectively through broad strategy efforts. The success of the company is based upon the combined success of the franchisor and the group of franchisees. The best franchises are built upon a web of successful operations.

**Types of Franchises**

Franchising can take on various forms including a product franchise, manufacturing franchise, and business format franchise. A product franchise is a form of franchise agreement in which a manufacturer allows a retailer to both distribute their

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products as well as use their names and trademarks. A manufacturing franchise is an agreement where a franchisor allows the franchisee to both produce and sell products using the name and trademark. Finally, a business format franchise involves the franchisor providing a business for the franchisee to run, with the name and trademark. This is the form that most people are likely to be familiar with. It involves more independent operations by the franchisee than the other two forms. For this analysis, the business format franchise will be the main focus because there is a higher level of franchisee control at the operational level and more oversight managerial duties are required of the franchisor. Due to this, it is a type of framework in which many common franchise conflicts can occur.

All of these forms discussed may reflect one of two structures. First, the franchisor may own the right to the name or trademark and simply sell the right to use that property to a franchisee. The latter form involves the franchisor proving support and services to a franchisee that adheres to specific rules and conforms to the franchisor’s strategic and tactical decisions. When discussing the complexities of the managerial relationship between a franchisor and franchisee the second form is more relevant as the tighter control can lead to greater conflicted interests.

**How Franchising Works**

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Franchising relies upon an agreement between the franchisor and the franchisee. The franchisor grants the franchisee license to the franchise in exchange for an investment and residual financial agreement. A franchise is not a truly independent business. The franchisee purchases the right to operate the business, but often they are subject to do so according to detailed operational criteria. Consistent quality is crucial to the success of franchises, so it is far more likely for a franchisee to be more heavily controlled than informally managed.

However, this tight control does relieve the franchisee of some strategic decision making duties. Whether one views this as a positive or negative, it is often a less risky proposition than starting a business from scratch. The logistical side of the business such as store layout, employment planning, product assembly, marketing, accounting, service delivery, etc. is typically coordinated and enforced by the franchisor. Franchisees are typically afforded with both extensive initial training and support activities post launch. The idea is that franchisor’s provide proven methods that allow the franchisee to be successful.

The basis of the relationship is the franchise agreement. This agreement can be standard or customized, but consistently it is thorough and protects the franchisor’s

interests. This agreement outlines the terms of the relationship between the parties and stipulates the financial plan. The most important thing to note about the agreement is that it ensures that the franchisee is agreeing to uphold the franchisor's standard of doing business.

The franchisee benefits from this partnership, as he or she is now able to utilize insights and methods from the franchisor's proven track record of success. The franchisee can choose to run one or more business units and benefit financially from doing so. At its best, franchising is a mutually beneficial relationship to both parties that are actively pursuing the same goal.

**Size of the Market**

There are about 750,000 franchised units in the United States today. That number is growing each year and doesn’t account for the vast global expansion many U.S. based brands are engaged in. Appendix A displays the initial international expansion for many prominent names in franchising (see Appendix A). Franchise units are constantly expanding and it is projected that the franchising sector may reach $3.96 trillion by 2015 (according to Global Industry Analysts). Due to the high

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profitability for the relatively low risk and cost, franchises are growing at a swift pace and this is projected to continue.\textsuperscript{18}

\textbf{Key Players}

In the United States, franchises are seemingly everywhere and in abundant supply. Many of the most well known businesses in the United States are franchises. Some of the most prominent names are Subway, UPS, and McDonald’s. Appendix B discusses the consistency of a brand such as McDonald’s through the franchise system. The opportunity to become a franchisee with a top franchise company is a topic that gains a lot of recognition each year. There are many ranking systems to determine which franchisor is the best investment. One of the most prominent rankings is done by Entrepreneur. Entrepreneur creates an annual list of the best franchises in the United States. The listed companies have been selected based on many objective and quantifiable measures. The primary factors are financial strength, financial stability, size of the system, and the growth rate. Also considered are the startup costs, the percentage of terminations, the litigation history, and whether the company presently provides financing. No subjective measures are used such as satisfaction and management styles.\textsuperscript{19}

The top ten for 2013 is a diverse group ranging from hotels to gas stations, fast food to fitness centers. The number one spot belongs to Hampton Hotels followed by


\textsuperscript{19} entrepreneur.com Annual Ranking of Top Franchises in The United States
Subway, Jiffy Lube Int’l Inc., and Seven Eleven Inc. Next up is Supercuts, Anytime Fitness, Servepro, and Denny’s Inc. Wrapping up the list are two brands synonymous with franchise: McDonald’s and Pizza Hut Inc. This list reflects that franchising has certainly not been exclusive to one industry. (For a complete list of the top ten please refer to Appendix C.)

**Trends**

The future of franchising is projected to show much of the same growth seen over the past twenty years. It’s a tried and true model that has made many a franchisee rich and many a franchisor exorbitantly wealthy. However, there are minor changes in trends that are worth noting for the future of the industry. Many of the trends are increasing efficiency and utilizing partnerships to create economies of scale advantages.

One such trend is “multi-brand” franchising. The name refers to the many different brands that are under one organization. This leads to efficiencies and greater market penetration, ultimately resulting in higher profits. There are many reasons a brand may decide to pursue additional brands for their organization. The first is that the have fully built out their original brand in a market. If a territory is fully covered, companies must look to additional brands to drive additional revenue.\(^20\) Secondly, companies are finding that seasonal cycles are affecting their original brand and

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they are adding other brands to the mix that help to balance this cyclical revenue trend. This trend affects both franchisees and franchisors. The benefits outlined above manifest in different ways with the two parties, but can have huge upside potential on either side of the franchisee and franchisor relationship.21

Another trend is “co-branding” (see Appendix D). This is when a franchisee operates two different brands at one location. These types of stores have increased in volume over the past few years with great success. This format helps a franchisee save money on the leasing costs of a store and affords more opportunity for profit per square foot. This model can also help to balance out slow and busy times for different items. For example, a popular combination is Dunkin Donuts® and Baskin Robbins®. These locations are a compliment because one mainly sees a morning rush and the other an evening rush. This allows the space to be more profitable throughout the day. Even franchisor’s are seeing the value and providing incentives for their franchisees to co-brand.22

**Legality & Regulations**

Due to a delay in federal regulations for franchising, many state statutes were formed to oversee the franchise process. These statutes control the sale of

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franchises within state boundaries. Following the implementation at the state level, the federal government formed regulations that uniformly cover franchise operations known as the Federal Trade Commission Franchise Rule. This two-fold process has led to a sometimes convoluted web of regulations that vary on a state-by-state basis. Despite these challenges, franchises have successfully expanded both nationally and internationally, but not without a fair share of legal challenges. Recently the FTC updated the Franchise rule to help align the state and federal rules (see Appendix E).

The elements of the regulations can be simplified to the following. First, there is the Federal Trade Commission rule. Secondly, a variety of state statutes that oversee the offering and sale of franchises. Thirdly, several statutes at the state level that complicate the termination and renewal process known as the “state franchise relationship laws”. Finally, there are many industry specific statutes in place from both the federal and state governments.

The legally binding contract behind a franchise is the franchise agreement. The franchise agreement is essentially a form of a license agreement. License agreements in general are agreements between the licensor that holds the intellectual property rights and the licensee that is allowed to use them in exchange

for some incentive (typically financial). In a franchise agreement the intellectual property being licensed includes the designs, trademarks, trade secrets, business methods, personnel training, and company manuals. A franchise agreement allows the franchisee to extract commercial value from the intellectual property owned by the franchisor, primarily through the name and trademarks.

**Financial**

The finances behind a franchise vary greatly depending upon industry of the brand and geographical regions. Typically, the initial franchise fee ranges from several thousand to tens of thousands of dollars. Royalties are the subsequent payments that must be made to the franchisor. These payments are typically based upon the profit or revenues of a location. In some cases the royalties are a flat fee, but royalties typically run about five to eight percent of the revenues. Additional dues are typically collected for the company wide marketing fund, this amount is on average one to three percent of revenues. Additionally, the franchisor may include in the initial agreement that they can require upgrades to properties or other physical elements of the operation. In such cases, there may be spontaneous costs incurred by the franchisee due to upkeep and renovation projects.

**Marketing**

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One of the greatest strengths of franchises is the centralized marketing advantage. Individual business owners wouldn’t be able to make the financial investment that franchisors are able to make into advertising and marketing campaigns. There is also an established and experience public relations team in place to help handle any unforeseen problems that franchisees run into with the public that could be impossible problems for them to handle on their own and with their own budget. When franchisors pool together the resources of their many franchisees, they are able to finance effective world-class marketing potential. The marketing materials can include both broad company advertising campaigns and also provide individual franchisees with personalized advertising materials for their store promotions. These materials are likely of better quality than a franchisee could typically afford.

On the other side, marketing can be a point of conflict for the franchisor and franchisee relationship. Franchisees can disagree with the franchisor on how money is being spent. Advertising dollars come from the pool of franchisees, so it is unlikely that each individual franchisees expectations will be perfectly met when the franchisor attempts to spend the pooled money in the most effective way. For this reason it is advised that anyone looking into becoming a franchisee consider the company’s marketing in their decision as this component will have a huge impact on the success of individual locations.

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Location & Territory

A serious point of consideration for the franchisees is where their location or locations will be located. Franchisors must also focus on locations in terms of how their territories will be mapped out. It isn't advisable for franchisors or franchisees to leave these types of decisions up to intuitive thought. Today, many resources are available to both parties as they map out their company and store. National chains typically utilize geographic information system software to draws from census data, geo-mapping, and market trend data to select a prime layout for their stores. Some franchisors make this information available to franchisees selecting a location, but others do not. For those franchisees that don’t have access to the expensive tool franchisors are relying on, there are demographic reports representative of each zip code in the country. These reports typically cost a few hundred dollars, much less than the thousands of dollars alternative. Some points of reference the data can help a franchisee determine is income of the community, traffic patterns, lifestyle patterns, and population characteristics.31

Many of the most prominent franchisors don’t leave this decision up to the due diligence of the franchisee. In some cases, the location decisions are made by the territorial mapping work done by the franchise company. Franchisees can select from a pre-determined set of locations that the franchisors deems wise investments. To stray from this plan typically requires the franchisee present a sales pitch of the

desired location and then the franchisor can choose to unlock the area and allow the franchisee to operate there if it does seem like a well researched selection.\footnote{Barkoff, Rupert M., and Andrew C. Selden. \textit{Fundamentals of Franchising}. [Chicago]: American Bar Association, Forum on Franchising, 2008. Print.}

\textbf{The Parties}

There are two main parties involved in a franchise relationship: the franchisor and the franchisee. In a discussion about this relationship, it is first crucial to understand these two parties and why they enter into a franchise business relationship.

\textbf{Franchisor}

The franchisor is the company that sells the right to use the intellectual property and products of the company to a franchisee.\footnote{Teixeira, Ed. \textit{Franchising from the inside out}. [United States]: Xlibris Corporation, 2005. Print.} One example of a franchisor is McDonald's. The McDonald's Corporation has everything from the food assembly to the employee hiring practices pre-determined. McDonald's is simply selling the rights to use their recipes, trademarks, store designs, etc. to a franchisee in exchange for a financial incentive.

\textbf{Why Become A Franchisor?}
When an entrepreneur or group of entrepreneurs has been successful, they often begin to think about expansion. There are several options available when a company is looking to expand their business. One option is to expand the business through branches under company control. With this option the profits stay in the company, but this is the most expensive and hands on form of expansion. An alternative is to franchise the business. Franchising allows to entrepreneur to ensure that the brand will be operated in a uniform way as it expands. The franchise agreement gives the entrepreneur a chance to outline the procedures that have been successful so far. The consistent branding and name can be used at these new locations. The greatest positive, could be the franchisees themselves. Instead of relying on managers that don’t have stake in the company to run the business, franchisee that have made a substantial financial investment themselves fill the role of manager. Franchisees have a vested interested in making the location or locations successful because their finances have been tied to the performance. Essentially, the franchise format allows the company to expand without having to be hands on every step of the way. This can lead to rapid company growth across a wide range of territories that would otherwise be quite difficult.

Franchisee

Franchisees never actually own the business; instead they buy it. Franchisees are essentially the party that purchases the operation of a unit or multiple units of the business. They are awarded with a license to operate the franchise business when they buy. The portions of the business that the franchisee does own are the assets, unless otherwise specified in the agreement. As the franchisee runs their location or locations, they are responsible for some decisions, but the vast majority are already pre-determined by the franchisor. The franchisee agrees to uphold continuity for the franchise. The franchisee typically pays the franchisor either in a flat fee or in a percentage of profits or revenues. This is determined when the agreement is formed in the franchise license agreement.

The type of individuals that become franchisees greatly varies. Many franchisees are individuals that have the desire to work for themselves and own their own business. Many also see franchising as an opportunity to invest in a way likely to pay off. Franchisees take many forms, some own only one location through financing while others own all the stores in a geographical area through personal wealth. There are also investment groups that develop areas or represent several stores. This has become so prevalent in recent years that this type of franchisee now makes up about 50% of franchisees today.

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Arguably the most important step for a franchisee is picking the initial product or company to partner with. There are even consultants that make their living advising on franchising decision making. Many franchisees error before even beginning the process of operating the business by signing on with a franchise too quickly. It is important for franchisees to consider the many factors at play. Not only should a potential franchisee consider the initial costs, he or she should also consider what it would take to actually run the business: in terms of time and finances. Also it is wise to look beyond the information provided to you by the franchisor. Asking a current franchisee within the company one is looking at or gathering third party opinions can help potential franchisees avoid this mistake.

Another problem franchisees can run into is not balancing their passion with discipline. Many franchisees are eager to be successful and can expand too quickly. Being a franchisee is typically more of a long-term payout rather than a get rich quick scheme and it is important for franchisees to pace themselves and think twice about any expansions early on.

One of the most crucial elements of success for franchisees is building the right team around their business. Good employees have proven critical to success, particularly managers. A survey conducted with franchisees that had to terminate locations cited

poor choice in managers as the primary reason their business wasn’t successful. In many cases, the franchisee will, at least in initial stages, manage the location themselves. This can help to lower some of the cost, but it is imperative that this person demonstrates leadership ability. To have customers treated well it is important to treat the employees well too. For this reason, it is key for every franchisee to consider the management structure within their location or locations and plan on building an environment conducive to a highly motivated team.

A final note on franchisees that is key, is that they must be willing to work within the rules and structure laid out for them. Becoming a franchisee isn’t wise for the fiercely independent-minded thinker that wants to blaze a new trail in business. In a franchise, there are clear rules and standards that the franchisee must adhere to. Franchisees should be content with a by the book operating style. This style can be a positive and is what leads many franchisees into the business. Franchisees are afforded with tried and true methods that have proven successful on a grand scale.

**Why Become A Franchisee?**

Becoming a franchisee is ideal for those who want to operate a business independently, but also have the peace of mind of a successful model. The premise

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may seem flawed at first review: franchisees pay tens of thousands before their
operation can even begin to be built out and then they pay about ten percent of what
they make each month for the next decade or more. The reason this is a good model,
is that history has proven that franchisees are more likely to make more money and
faster through a franchising opportunity than they would on their own. There is also
great long-term potential for the return on investment. The royalties or other
monthly fees for the company wide marketing efforts can seem daunting initially,
but a well run operation placed in a great market opportunity can overcome those
costs. Beyond the financial incentive, it is a great way to oversee a business without
having to stretch oneself too thin. Many strategic decisions are made for the
franchisee and they have the freedom to focus on the operational side of things.

**Conflict Between the Parties**

Franchisors and franchisees both have an incentive to see their franchises be
successful. At the same time, this doesn’t mean that tensions and conflict do not
exist between the parties. Conflicting interests and misaligned goals can occur in a
franchise relationship no matter how clearly defined the roles are in the initial
franchise agreement. Despite the opportunities for success in the franchise sector,
hundreds of franchises do fail each year in the United States. Among the
contributing factors cited, mismatched goals between franchisee and franchisor

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ranks among the top. Each party has specific management concerns that can serve as the basis for the conflict.

**Management Concerns: Franchisor**

Among the most common problems franchisors face is the non-conformance of franchisees. Franchisors have had previous success with the guidelines and processes provided to the franchisee. Seeing these norms broken or disregarded is of great concern to a franchisor seeking to maximize their profits. An additional problem arises when the two parties aren’t seeing eye-to-eye on steps to improve the business.\(^{46}\) Although franchisors and franchisees should all want the company to be successful, they can have different ideas of what decisions will lead to that result. For example, the franchisor may want all of the locations to update their exterior decoration, but the franchisee sees this as a high cost project that isn’t necessary. It can also be quite difficult to gain the cooperation of the large group of franchisees working with the company.

**Management Concerns: Franchisee**

The franchisees have their own set of concerns. Most prominently, they can tend to avoid activities that require additional investment if they don’t believe there is an opportunity for return on their investment. Also, the longer they’re involved with

the business they can begin to desire a more hands on approach to the decision making components of their business. On the other hand, the franchisee can feel that they aren’t getting the support they were initially promised. They can begin to feel that they are on their own and aren’t receiving anything in exchange for the royalties they are paying each month. All in all, the basis of frustrations for the franchisee is typically related to feeling overly controlled or lacking support from the franchisor.

Common Points of Conflict

Although the franchisor and franchisee relationship can in some cases be very positive, oftentimes there is a conflict at some point in the relationship. Although these conflicts don’t have to mean the end of a working relationship, they can become serious enough to require the attention of both parties seeking to find common ground. In Appendix F some of the main causes of conflict are outlined from both the perspective of the franchisor and the franchisee. Some of these main causes are franchisor deceit, poor communication, and marketing issues. The table illustrates the all to common gap in the perceived cause of the conflict as many of the items a disproportionately ranked with higher importance by one party than the other. The results give greater insight into how mistrust and differences between the two parties can muddy a working relationship. Particularly with examples such as “deceitful franchisor behavior,” which has a ranking of ten from franchisees and

isn’t ranked by franchisors. This disconnect can lead to difficult to maneuver relationships for both sides.

It is important to look deeper into the causes of conflict. One example of conflict between the two parties is a feeling from the franchisee that they lack the franchisor’s support. This is the most commonly cited complaint of franchisees that are dissatisfied with the experience. This is a tough conflict to maneuver, because the two parties can have very different perspectives on what is supportive behavior. Many franchisees have noted feeling like they handed over their money and have had to adhere to strict rules while fending for themselves. This feeling may arise from a franchisor overseeing too many operations or simply not understanding the needs of their franchisors. At the same time, the franchisor may not even realize this is a problem and could prove to be a better resource if pursued for help. This is a case of unmet expectations for the franchisee, so perhaps the problem lies in how the opportunity was presented to them in the initial stages of setting up the operation. The main problem here is that both sides have not properly communicated to each other what to expect and what their expectations are.

A second source of conflict can be poor communication. This is another problem recognized more so by the franchisees. In this instance, franchisees often feel that they aren’t receiving enough information about various components of the business

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that they need as managers. Franchisees can often feel that they lack information needed on matters such as the direction of the broader company and requirements for them as operators. This communication problem can also go the other way. Franchisors have complained that franchisees fail to keep them informed on the health of their operation and when they feel they need additional support.

Communication problems may be based on a lack of capacity to communicate; there just isn’t enough time to share all the information the other party wants. On the other hand, it can come down to a matter of willingness. Both parties may feel that sharing the information is unnecessary and frivolous. The most extreme cases of communication problems can be based in a lack of trust between the parties.

A third example of conflict is profitability. This is an issue more highly ranked as a cause of conflict by the franchisors. Franchisees also see this as a problem, but they see this as a problem based upon the lack of support discussed earlier. While franchisors might see profitability as the whole problem, many franchisees see profitability as a symptom of a bigger problem. Metrics of performance, such as profit, display results that depend upon other systems being in place. In theory, low profits mean low levels of performance in other aspects of the business. At the same time, sometimes a franchisee can be doing the right things and see low profits. In these instances conflict can arise, as low profits are disappointing to both parties.

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A fourth basis for conflict is the marketing program for the company. Marketing is one of the benefits that franchisees receive from joining a franchise because they have access to premium advertising they couldn’t typically afford on their own. At the same time, the large numbers of franchisees aren’t always going to agree on how the advertising dollars are being spent by the franchisor.\(^5^3\) This is one point of conflict where the end goal is truly aligned. Both parties are interested in seeing marketing that drives profit and growth for the company. The problem is that money can be spent on campaigns that are more successful for some geographical areas than others and the remaining franchisees feel let down. At the same time, the franchisor can feel a lot of pressure to make the campaigns successful and credit poor performance at these locations to other factors if the problem is persistent with a specific group of stores. The main issue with this problem is the lack of control that the franchisees can feel and the abundant pressure put on the franchisors to effectively manage marketing initiatives that drive the greatest results possible.

Another issue arises in terms of how compliant the franchisee is with the brand’s format and standards. This is a problem that impacts the franchisor’s discontentment levels more so than the franchisee, but the impact is felt on both sides. Oftentimes, a franchisee can find the rules in place too rigid or unnecessary. This can happen in cases where the franchisee thinks a different way of doing things

would be more profitable. At the same time, a franchisor can feel that the compliance is not only necessary, but also the only way to maintain the strength of the brand. Not following the systems the franchisors have laid out can signal a lack of loyalty to the brand. Franchisors can even begin to worry that one store not conforming can weaken the entire system of stores and the brand they’re helping to build. The franchisee can argue in turn that the entire system can be improved with their implementations in place. This whole scenario really showcases the power struggle that can happen between the two parties. At the end of the day, both think they have a better way and typically this is a hard standoff to mediate.

Next, there can be an issue of an inexperienced franchisor. This is a complaint sometimes put forth by franchisees. In small system franchises, the franchisor may not understand the best way of doing things yet. If one of their franchisees is seasoned at dealing in the franchise business, they can become upset with the leadership they find themselves under. One key problem with young franchisors is that they can expand too quickly and then not have the capacity to provide support to their franchisees.

Also, there can be a problem between the parties in relation to fees. The fees in question refer to the royalties and marketing contributions the franchisees make to the brand. Not surprisingly, this is a much more common complaint from

franchisees than franchisors.\textsuperscript{56} The complaint here is similar to the complaint about support. In essence, franchisees argue that they’re paying for support with these fees and not receiving it. The franchisor can argue that, unless otherwise specified, the fees mainly exist to compensate the company for the use of their brand and other trademarks.

Another source of conflict is territory constraints. This is a source of conflict cited by franchisees because they feel that franchisors can sometimes make it difficult to expand. Tight regulations in terms of territory have been growing in recent years and it can be more and more difficult for franchisees to expand their operations.\textsuperscript{57} Franchisors can argue this is in place to protect the franchisee from over-reaching or growing too rapidly and too early.

A final source of conflict is misrepresentations from either party. This issue is more highly ranked by the franchisor than the franchisee. Franchisors note that misrepresentations occur mainly in terms of the inaccurate earnings claims filed by franchisees.\textsuperscript{58} This may not be an intentional misleading by the franchisee; sometimes this number is calculated differently in instances where the franchisee puts more emphasis on the inputs that the earnings had to offset. Franchisees mostly complain about misrepresentations prior to joining the franchise and


wishing they had known the full story before signing up with the franchise. Typically the complaints are that more support was promised than was received. The basis of this problem is a culture of mistrust between the parties.

**Solutions to Align Goals and Enhance Trust**

The problems outlined are likely to arise with most franchisor and franchisee relationships at some point, but they don’t have to grow into a large problem for either party. There are ways to address these issues and improve the satisfaction of both parties and the success of the company.

**Formal Solutions to Conflict**

First it is important to understand some of the formal measures that are taken when conflict interferes with business operations or success. Most of these items outlined represent the worst-case scenario when the solutions outlined later in the report are either not implemented or fail to curb the conflict.

Three of the most common forms of dealing with conflict between franchisors and franchisees are correspondence through a solicitor, mediation, and in extreme cases even litigation. Before the conflict gets to this stage both parties typically pursue a more informal mean of verbal negotiations. This tactic is even more common for

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franchisees than franchisors. Franchisors are more likely to take a more formal approach. This is likely due to the scope of a typical franchisees role compared to a franchisor. The more formal techniques of the franchisor are likely due to the corporate structure they operate in and their status as a publicly traded company. Another reason the formal techniques serve the franchisor well is that they have the franchise agreement typically built to protect them. Both sides have their interest served by this contract, but typically it is written by lawyers at the company and helps to safeguard franchisor interests. At the same time, a willingness to engage in verbal negotiations could save the franchisor the trouble of legal means or even the trust of their franchisee. A franchisee is likely to more highly value the partnership between the two and it is necessary for the franchisor's reputation to at least maintain some level of sensitivity to this. If the franchisor and franchisee cannot align their views on the conflict the franchisor can file a breach notice. This is a solution in a legal sense, but doesn’t help to mend the relationship. At the same tie, the large number of franchisees under a company can band together against the franchisor in an association if they feel they have been collectively wronged. Again, this isn’t a way to improve the actual relationship and looks only at the symptom of the conflict.

Alternative Solutions for the Franchisor

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It is in the best interest of both parties for both the franchisor and the franchisee to be successful. For that reason it is preferred that the relationship be a positive one built on trust and respect. In this environment conflicts may still arise, but they can more easily be solved through cooperative behaviors. Instead of looking at solutions for the problems identified, it is better to focus on the route causes of these problems and the steps each party can take to eradicate them.

The first step a franchisor can take is to listen to their franchisee. Franchisees that are most satisfied with their franchise claim that they are a secure part of a united group.\(^6\) Franchisees that feel that way about the company they have joined are often just being communicated with more effectively. This means listening to the franchisees concerns and responding to them. One characterization of companies doing this well is that they have frequent opportunities for franchisees to converse with each other and the company.\(^\)\(^6\) Meetings and conferences can go a long way in helping to build a sense of security and trust. Also, franchisors can benefit from the input they receive from their franchisees through these outlets. After all, franchisees have more hands on experience with operations and may be able to help steer the future of the business through their perspectives. The key to successful communication with franchisees is to cultivate a collaborative environment and let them feel heard.

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Secondly, constantly seek to improve the business for the franchisees. This means a more hands on approach, but can also mean more profits. The franchisor lays out strict requirements for the franchisee, but great franchisors also seek to help the franchisees be successful in that framework. This means taking steps such as negotiating better deals with suppliers and improving the productivity systems in place. Moreover, franchisors should be providers of business information to the franchisees. Help nurture their ability to run an effective store by cultivating their knowledge of successful business practices through educational seminars and newsletters. This includes keeping franchisees up to date on marketing plans and the logic behind them. The investment will pay off if the curriculum is helping set up the franchisees to succeed. Franchisors should be aware that the franchisees needs do evolve over time, and the more training and support provided along the way the greater output and loyalty the franchisee will likely have. Research has proven that franchisees are more likely to recommend becoming a franchisee with their company to a friend if they feel that the company has actively cared about their success.

Additionally it is important for the franchisor to come off as a leader worth following. If franchisors have clear goals for their organization, what is the benefit from hiding this information from franchisees? Franchisees want the business to be

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successful as well. Never hearing about the goals and plans for the future can leave
the franchisee wondering how they fit into the future of the company. For this
reason, it is advisable for franchisors to be more open about big company decisions,
milestones, and goals. This doesn’t mean sharing all of the information, but
sharing key insights that directly affect the franchisees can build more trust in the
relationship. Not only that, but it can also help to establish a sense of respect in the
leadership and the brand.

Finally, it is important for franchisors to realize that conflict is inevitable, but
doesn’t have to grow into a major problem. Research has shown that conflict is the
main reason people try to sell their franchise. Conflict is a likely occurrence in a
working relationship, especially in franchising, but it doesn’t have to be
relationship-damaging conflict. Franchisors are wise to develop a conflict
management program within their company that comes before the formal means
outlined earlier. Many conflicts can easily be resolved if a solution is actively
pursued. A franchisor taking initiative to improve the relationship can build
valuable trust with the franchisees. Difficult issues can be discussed and resolved if
one party is willing to take the initiative. Due to the importance of the health of a
relationship for the franchise process to work, it is a wise investment for a
franchisor to work to maintain strong relationships.

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The main goal of both parties is to make a profit, but a healthy relationship is key to financial success. Franchisee satisfaction is heavily based upon return on investment, but also on more subjective measures such as a feeling of respect and optimism about the future. Franchisors are wise to recognize this and take the steps outlined to proactively pursue conflict resolution.

**Alternative Solutions for the Franchisee**

Some level of disagreement and debate from the franchisee to the franchisor can help grow the business. At the same time, there is a point where it can become excessive and ultimately damage the relationship or even lead to legal troubles for the franchisee. Similar to the franchisor, there are steps the franchisee can take to help improve the relationship dynamic between the two parties.

Firstly, seeking out the advice of the franchisor can improve both the franchisees performance and the relationship. Sophisticated franchisors are keeping tabs on the performance of their many franchisees and the reasons behind the numbers. Instead of feeling micro-managed and controlled, franchisees can look to see this as a positive and a resource. Actively pursuing this information and similar feedback shows the franchisor that the franchisee is committed to the shared goal of a profitable store. Opening communication tracks about performance can also help the franchisor be more understanding when the franchisee is underperforming or

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faces challenges. Maybe not all of the advice will be beneficial, but the culture of trust being cultivated certainly will be to both parties benefit.

Secondly, franchisees should seek to stay within the rules laid out for them. This can be more difficult than it sounds, but also accounts for several of the causes of conflict from a franchisor’s perspective. Franchisors can be guilty of outlining too harsh of goals and regulations for the franchisee. At the same time, these rules were laid out in the original agreement and it is the franchisees duty to follow them.\(^{70}\) If a franchisee sees a problem with the rules, it is important to communicate these differences and seek a solution. If the franchisor isn’t willing to reconsider, a franchisee shouldn’t break the rules regardless, as this is the leading cause of litigation in franchise relationships.\(^{71}\)

Next, franchisees should focus on clearly documenting information about their store and communicating this to the franchisor. The more information the franchisee collects and communicates, the more trust the franchisor can have in their operation. The franchisor is managing many franchisees. For this reason, the franchisee can establish a positive relationship through reliability. If conflict does arise, the franchisor can see that the franchisee has been open with communications and cultivating trust through formal means. This style appeals to franchisors as they


are running complex operations. Although a franchisee may prefer a more personal touch, understanding the franchisor’s need for formality can improve the relationship.

Finally, franchisees should make an effort to connect with their territory or area managers. In many cases, the territory and area managers can seem like the police of the system. It is their job to measure how well the store is performing and if the rules are being followed, so for many franchisees this is a relationship with a negative connotation. Franchisees could be more successful if they choose to look at these managers in a different way. These people report on the franchisee’s performance and therefore hold a lot of power. For this reason, franchisees should look at what a positive relationship could mean for their business. There are better opportunities and support offerings for stores that the area manager enjoys working with. Franchisees that make it a point to build a relationship with this manager, offer up additional information, and even ask for feedback can help to improve their overall relational standing with the company.

Just as franchisors can take steps to improve this relationship, franchisees have the power to control their satisfaction with these interactions. Franchisees are wise to see the franchisor as part of the same team and a resource. Taking the outlined steps can show a sense of cooperation that franchisors seek out in people they want to

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work with. Furthermore, franchisees typically have less power in terms of a legal struggle than franchisors. For this reason, measures to maintain a healthy relationship and not let conflict become too serious are particularly aligned with franchisees’ interests.

**Conclusion**

Relational conflict can arise within a franchise partnership that may seem insurmountable to the parties. This can lead to low satisfaction or an end to the business relationship. Although conflict will inevitably occur, it doesn’t have to weigh on either party or damage the relationship. This analysis set out to define the problem and identify solutions. An overview of the unique structure of franchising as a business model gave insights into the potential areas for conflict. Delving deeper into the interests of both parties furthered this analysis. Discussing causes and examples of conflict painted a picture of what an unhealthy franchise relationship can look like. Finally, the solutions presented for both parties showed that with recognition of the aligned goals, franchisors and franchisees could see each other as allies. Maintaining positive relationships can be difficult, particularly in a business relationship, but beyond the metrics of performance, positive relationships are proven keys to success. Franchises can benefit from understanding ways to improve these working relationships.
Appendix A: Initial International Expansion

Going International – The First Countries Franchises Expanded Into.

Source: http://healthmarketinnovations.org/
Appendix B: Continuity in the McDonald’s Franchise

The Big Mac ® (pictured below) is a famous McDonald’s recipe. Due to franchising this product is made by the same recipe and with the same ingredients to produce the same tasting burger, everywhere in the world. This is the power of franchising for brand continuity.

Source: McDonald’s ®
## Appendix C: Entrepreneur’s Best Franchises in the U.S. 2013


<table>
<thead>
<tr>
<th>RANK</th>
<th>FRANCHISE</th>
<th>STARTUP COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hampton Hotels</td>
<td>$3.7M - 13.52M</td>
</tr>
<tr>
<td></td>
<td>Mid-priced hotels</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Subway</td>
<td>$85.2K - 260.35K</td>
</tr>
<tr>
<td></td>
<td>Submarine sandwiches &amp; salads</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Jiffy Lube Int'l. Inc.</td>
<td>$196.5K - 304K</td>
</tr>
<tr>
<td></td>
<td>Fast oil change</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>7-Eleven Inc.</td>
<td>$30.8K - 1.5M</td>
</tr>
<tr>
<td></td>
<td>Convenience store</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Supercuts</td>
<td>$103.55K - 196.5K</td>
</tr>
<tr>
<td></td>
<td>Hair salon</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Anytime Fitness</td>
<td>$56.3K - 353.9K</td>
</tr>
<tr>
<td></td>
<td>Fitness center</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Servpro</td>
<td>$133.05K - 181.45K</td>
</tr>
<tr>
<td></td>
<td>Insurance/disaster restoration &amp; cleaning</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Denny’s Inc.</td>
<td>$1.18M - 2.4M</td>
</tr>
<tr>
<td></td>
<td>Full-service family restaurant</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>McDonald’s</td>
<td>$1.07M - 1.89M</td>
</tr>
<tr>
<td></td>
<td>Hamburger, chicken, salads</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Pizza Hut Inc.</td>
<td>$295K - 2.15M</td>
</tr>
<tr>
<td></td>
<td>Pizza, pasta, wings</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>H &amp; R Block</td>
<td>$31.51K - 138.7K</td>
</tr>
<tr>
<td></td>
<td>Tax preparation &amp; electronic filing</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Jimmy John’s Gourmet Sandwich Shops</td>
<td>$305.5K - 487.5K</td>
</tr>
<tr>
<td></td>
<td>Gourmet sandwiches</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Dunkin’ Donuts</td>
<td>$310.25K - 1.77M</td>
</tr>
<tr>
<td></td>
<td>Coffee, doughnuts, baked goods</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Hardee’s</td>
<td>$1.09M - 1.58M</td>
</tr>
<tr>
<td></td>
<td>Burgers, chicken, biscuits</td>
<td></td>
</tr>
</tbody>
</table>
Appendix D: Co-Branding

Source: Yelp.com
Appendix E: Federal Trade Commission Franchise Rule
(This document from the Federal Trade Commission displays the purpose for amending the former rule, see highlighted portion).

FTC Updated Franchise Rule

The Federal Trade Commission has approved amendments to the Franchise Rule, which was originally promulgated in 1978. The amended Rule has a phased-in effective date: as of July 1, 2007, franchisors may follow the amended Rule, or they may continue their current practice of complying with the original Rule or individual state franchise disclosure laws that require an Uniform Franchise Offering Circular ("UFOC"); but by July 1, 2008, they will be required to follow the amended Rule only.

The Franchise Rule gives prospective purchasers of franchises the material information they need in order to weigh the risks and benefits of such an investment. The Rule requires franchisors to provide all potential franchisees with a disclosure document containing 23 specific items of information about the offered franchise, its officers, and other franchisees. Required disclosure topics include, for example: the franchise’s litigation history, past and current franchisees and their contact information, any exclusive territory that comes with the franchise, assistance the franchisor provides franchisees, and the cost of purchasing and starting up a franchise. If a franchisor makes representations about the financial performance of the franchise, this topic also must be covered, as well as the material basis backing up those representations.

A primary goal in amending the Rule was to harmonize the federal Rule with state franchise disclosure laws. The Commission’s amendments also serve the purposes of updating the original rule to adapt to changes in the marketing of franchises and new technologies, reducing compliance costs where possible, and addressing complaints voiced by many franchisees during the amendment proceeding about the franchisees’ experience with franchisors after they have signed an agreement and entered into a franchise relationship.

The Rule amendments bring the FTC’s Rule into much closer alignment with state franchise disclosure laws, which are based upon the UFOC Guidelines, developed and administered by the North American Securities Administrators Association ("NASAA"). Although the amended Rule closely tracks the UFOC Guidelines, in some instances it requires more extensive disclosures – mostly with respect to certain aspects of the franchisee-franchisor relationship. For example, the amended Rule requires more extensive disclosures on: lawsuits the franchisor has filed against franchisees; the franchisor’s use of so-called “confidentiality clauses” in lawsuit settlements; a warning when there is no exclusive territory; an explanation of what the term "renewal" means for each franchise system; and trademark-specific franchisee associations. In a few instances, the amended Rule requires less than the UFOC guidelines – for example, it does not require disclosure of so-called “risk factors,” franchise broker information, or extensive information about every component of any computer system that a franchisee must purchase.

The original Rule covered, in a single Code of Federal Regulations Part, two distinct types of offerings: franchises and business opportunity ventures. Many of the very familiar national fast-food restaurants and hotels, for example, are franchises; business opportunity ventures include vending machine routes, rack display operations, and medical billing schemes ventures. These ventures, unlike franchises, typically do not involve the right to use a trademark or other commercial symbol. Nevertheless, they do call for the opportunity seller to provide purchasers with locations for machines or equipment or with clients. The amended Rule separates the requirements applicable to franchises from those applicable to business opportunity ventures. Part 436 of the amended rule covers only franchises, while a newly-numbered Part 437 preserves the text of the original rule in so far as it covers business opportunity ventures. The Commission is conducting a separate proceeding to consider amendments to what is now designated Part 437, the Business Opportunity Rule.

The text of the amended Rule and the text of the amended Rule’s Statement of Basis and Purpose, which summarizes the rulemaking record and explains the rationale for the amendments, are available as a link to this press release and will be printed in the Federal Register Notice.

The Commission wishes to acknowledge the very thoughtful contributions that NASAA and individual state officials provided Commission staff throughout the Rule amendment proceeding. The Commission vote approving publication of the Federal Register notice was 5-0.

Appendix F: Table 1 – Cause of Conflict Survey Results

Table 1: Cause of Conflict Survey Results

“Causes of conflict are listed in the following table and show their comparative ranking between the franchisee perspective, and the franchisor perspective.”

<table>
<thead>
<tr>
<th>Response (Cause of conflict)</th>
<th>Franchisee Ranking of Dispute Cause</th>
<th>Franchisor Ranking of Dispute Cause</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of support from franchisor</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td>Compliance with system</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Fees</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Communication problems</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Misrepresentation issues</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Marketing issues</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Profitability</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Franchise agreement issues</td>
<td>8</td>
<td>No ranking</td>
</tr>
<tr>
<td>Territorial issues</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Deceitful franchisor behavior</td>
<td>10</td>
<td>No ranking</td>
</tr>
<tr>
<td>Too much control imposed by the franchisor</td>
<td>11</td>
<td>No ranking</td>
</tr>
<tr>
<td>Stock issues</td>
<td>12</td>
<td>No ranking</td>
</tr>
<tr>
<td>Other causes of dispute</td>
<td>13</td>
<td>10</td>
</tr>
</tbody>
</table>

Franchisee versus Franchisor ranking of Dispute Causes. Compiled from: Towards Conflict Resolution Australian Survey 2009 (Griffith University), and Franchising Australia Survey 2010 (Griffith University).
Bibliography


